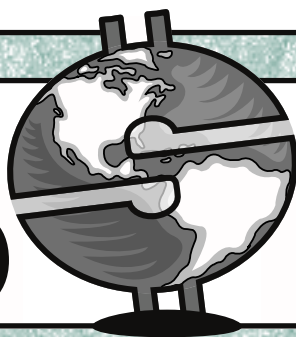


# Your VESTED



# INTEREST

North Dakota State Investment Board

September 2005

## SIB DIVERSIFIES REAL ESTATE

Since the 1980's, the North Dakota State Investment Board (SIB) has invested in Real Estate on behalf of its Pension Trust clients. The Teachers' Fund for Retirement (TFFR) and the Public Employees Retirement System (PERS) are participants in the Pension Trust. At this time, TFFR allocates 9% of its total portfolio to this asset class, while PERS maintains a 5% exposure. Investment managers INVESCO and JPMorgan each manage about half of the portfolio.

Investing in Real Estate has provided diversification for these funds because it has opened up a source of investment return that has a fairly low level of correlation to stock and bond returns. Over the years, Real Estate has been a solid performer. This past fiscal year ended June 30, 2005, this asset class provided a 20.8% return. It has averaged 10.5% per year for the five years ended on June 30, 2005. These steady returns certainly helped the Pension Trust weather the volatility of the stock market during this same multi-year time frame.



Our investments in Real Estate have been geographically distributed across the United States and represent holdings in four basic categories: office buildings, retail establishments, multi-family housing facilities and warehouse / distribution complexes. This diversification by geography and building type, in the context of a multi-manager approach, has served us well.

As the Real Estate allocation in the Pension Trust has grown beyond \$200 million, the SIB has moved to expand its diversification into complementary types of investments through its upcoming participation in the JPMorgan Alternative Property Fund (APF). APF will invest in non-traditional assets such as assisted living facilities, hotels and resorts, student housing, manufactured housing, self storage facilities, and medical offices throughout North America. The alternative property type opportunity set represents approximately 30% of the US real estate investment universe.

APF will proactively reallocate capital among the different alternative property sectors, depending on changing economic and property market conditions. Here is a brief description for selected property types within the alternative sector:

- **Assisted Living / Senior Housing** – Current occupancy is 85%. This sector currently provides for high yields with upside. Rising household incomes and ultimately, aging baby boomers will raise the long-term demand for this type of housing.
- **Medical Office** – Current occupancy in this sector is 90% compared to 83% for traditional office properties. The medical services industry is growing rapidly with little impact from the business cycle. US health-care spending is expected to double within the next seven years to above \$3 trillion.
- **Hotels** – Current occupancy is near 70%. Hotels are rebounding sharply after the impacts of terrorism and the recession on business and leisure travel.
- **Self-storage** – Enjoys a current occupancy of 85%. This sector has counter-cyclical characteristics and provides for relatively stable cash flows. It is a highly-fragmented but rapidly consolidating sector.
- **Manufactured Housing** – Current occupancy is 87% in this sector. One out of thirteen Americans lives in a manufactured home. Past over-production has created a slowdown which APF managers believe will yield attractive opportunities for community and loan acquisitions.
- **Student Housing** – Current occupancy for this sector is 89%. Children of baby boomers are expected to begin entering college-age cohort. This should lead to a substantial increase in the demand for student housing.

The SIB will begin to integrate these new property types during fiscal year 2006. While the future of investments cannot be accurately predicted, the SIB is confident that this increase in diversification will augment the risk / return profile of this interesting asset class.

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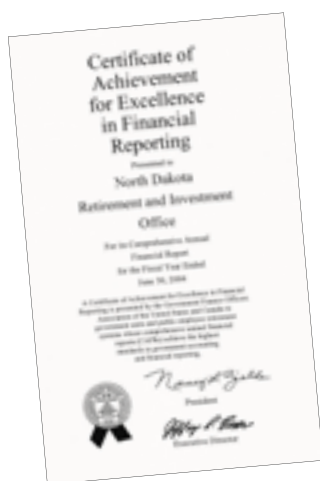
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Steve Cochran, CFA  
Executive Director/CIO



## ACHIEVEMENT AWARD RECEIVED

The ND Retirement and Investment Office (RIO) is pleased to announce that its Comprehensive Annual Financial Report (CAFR) for June 30, 2004 has qualified for a Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association (GFOA).

The Certificate of Achievement is the highest form of recognition in public employee retirement system accounting and financial reporting, and its attainment represents a significant accomplishment. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

## FROM THE DIRECTOR'S CHAIR

For the past 24 years, I have worked in the institutional investment industry. Prior to joining the North Dakota State Investment Board in 1997, my experience was all in the private sector. Joining an investment management company straight out of business school, I had the opportunity to learn from experienced professionals, and occasionally "borrow" some of the stock phrases they would use in client meetings from time to time.

As I reflect on the great success of our SIB investment program this past fiscal year, I feel compelled to recall one such standard edition from the client communication memory bank. Whether presenting performance results far north or far south of the average, this one particular business associate was fond of saying, "sometimes we look a lot smarter than we really are, and sometimes we look a lot dumber than we really are, and the truth is probably somewhere in between," followed by some recognition of what the investment results were indicating. It never got much of a laugh, but I think I will borrow it anyway. And I am glad to report that this time, we are looking smart!

funds returned 14.07% and 13.36%, respectively.

For relative comparison purposes, we calculate how the investment pools would have performed if they were simply a weighted average of the indexes or benchmarks that represent their asset class opportunity set. We call these the "policy target benchmarks" and they returned 10.46% for PERS and 11.68% for TFFR. You can tell by comparing these numbers that PERS and TFFR have different asset allocations, and that excess returns were not simply a function of expected risk.

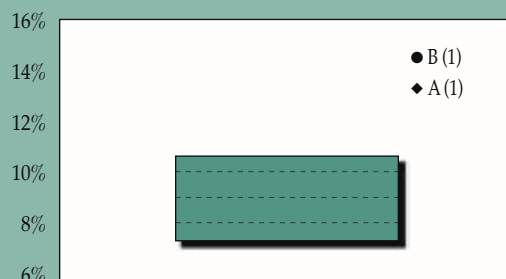
Having compared ourselves to ourselves, it is interesting to see where we stacked up when measured against a universe of similar funds from around the country. The universe we use represents over \$700 billion in pension assets in over 100 funds and is a good representation of what similar public pension plans experienced last fiscal year in the investment markets.

Exhibit 1 is a floating bar chart and it plots our PERS and TFFR plans against the entire measured universe

As the charts and tables on the opposite page indicate, the PERS and TFFR plans had very good years in the investment markets in both relative and absolute terms. In absolute terms, the gross return for PERS was 14.86%, while the TFFR enjoyed a gross increase of 14.17%. Net of fees and expenses, the PERS and TFFR

### Exhibit 1

#### Total Fund Rankings Compared to Callan Database for Year Ended June 30, 2005



Year Ending 6/30/05	
10th Percentile	10.68
25th Percentile	9.99
Median	9.22
75th Percentile	8.29
90th Percentile	7.42
TFFR Total Fund	◆ A 14.17
PERS Total Fund	◆ B 14.86



on a gross return basis (because plans have different levels of fees and expenses). As you can see, the North Dakota duo performed very well, ranking in the top 1% of all funds in the annual study.

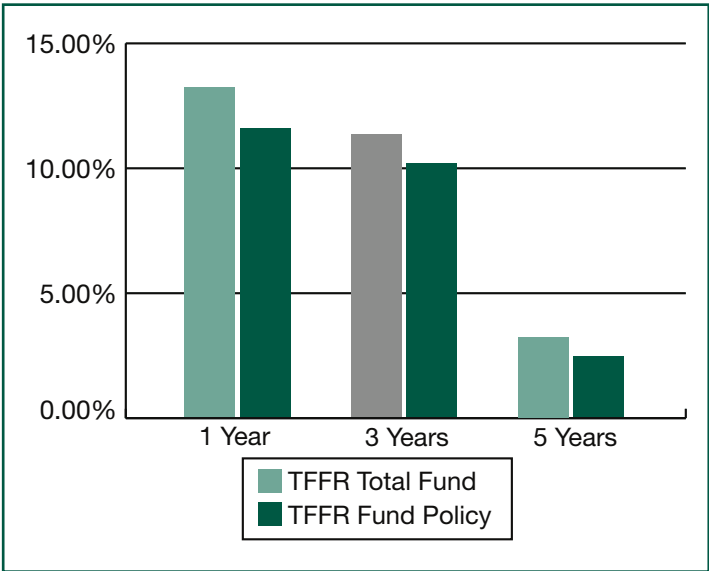
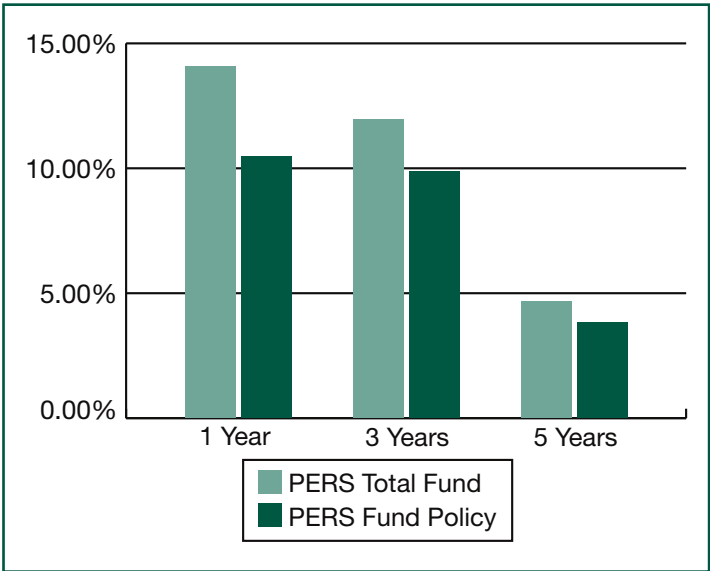
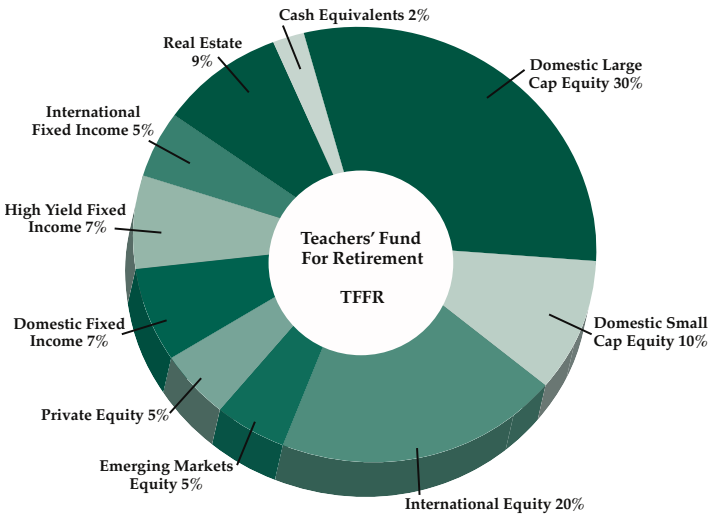
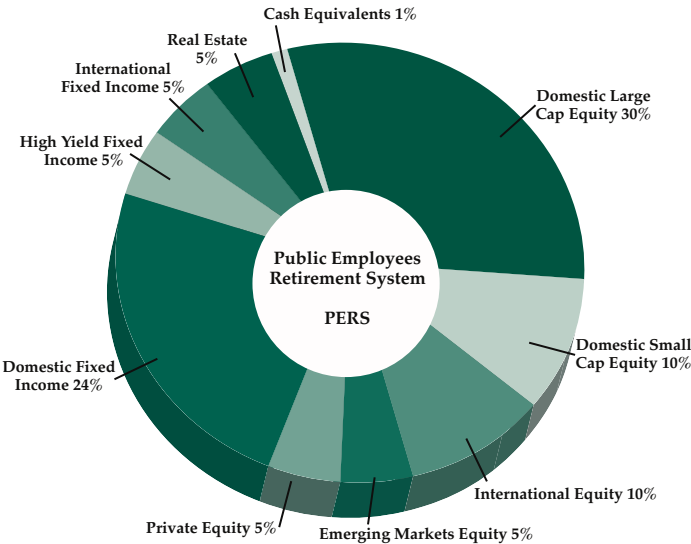
I also find Exhibit 2 comforting in that it shows that our relative performance advantage did not just come from one or two areas of investment. In fact, as measured by our investment consultant, all of our asset types performed very well over the same period, contributing to an overall outstanding year. Similarly, our broad asset classes performed well over the entire five year period ended June 30, 2005, landing our funds in the top third of the universe using this measurement for

Exhibit 2	
Broad Asset Class	Performed in the top:
Domestic Equity (US Stocks)	25%
Domestic Fixed Income (US Bonds)	1%
International Equity (Non-US Stocks)	5%
International Fixed Income (Non-US Bonds)	10%
Real Estate	27%
Cash Equivalents	28%

the multi-year period which includes the rough investment markets of the early 2000's.

So, if the program makes us all look "smarter than we really are" for the time being, we'll take it. But, as you

see so often in the investment industry, "past performance is no guarantee of future results," so we will remain vigilant, maintain risk controls, and work hard for the continued success of the SIB investment program.





## SIB OFFICERS ELECTED

The State Investment Board (SIB) recently held its annual election of officers. By unanimous vote, the SIB chose the following members to hold leadership positions for the 2005-2006 fiscal year:



Lt. Governor  
Jack Dalrymple  
*Chairman*



Howard Sage  
*Vice Chairman*



David Gunkel  
*Parliamentarian*

## SIB AUDIT COMMITTEE REAPPOINTED

The Audit Committee, the only standing committee of the SIB, consists of five members: three members of the Committee represent the three groups on the SIB (Teachers' Fund for Retirement Board, Public Employees Retirement System Board, and the elected and appointed officials). The other two members are

selected from outside of the SIB and are auditors with a Certified Public Accountant (CPA) or Certified Internal Auditor (CIA) designation.

All five members were reappointed in July. The members are Barb Evanson, representing TFFR; David Gunkel, representing PERS;

and David Sandy, designee of Sandy Blunt of Workforce Safety & Insurance, representing elected and appointed officials. Rebecca Dorwart, CPA and CIA with MDU Resources Group, Inc. and Lonny Mertz, CPA, CIA, and CFE (Certified Fraud Examiner) of Job Service North Dakota, serve as the independent participants.

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